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**To the Citizens, Governor and
Members of the South
Carolina General Assembly**

I am pleased to present to the citizens of South Carolina this Comprehensive Annual Financial Report for the State of South Carolina for the fiscal year ended June 30, 2002. The report provides financial information about the State's operations during the year and describes its financial position at the end of the year.

Management is responsible for the accuracy of the data in this report as well as for the completeness and fairness of the presentation. To the best of our knowledge and belief, this information is accurate in all material respects and is reported in a manner that presents fairly the State's financial position and results of operations and provides disclosures that enable the reader to understand the State's financial condition. For the convenience of users, we have divided the report into three sections as follows:

- The Introductory Section, containing this letter of transmittal; the Certificate of Achievement for Excellence in Financial Reporting for the report as of June 30, 2001; a list of State officials; and an organizational chart of State government.
- The Financial Section, including the independent auditors' report, management's discussion and analysis, government-wide financial statements, fund financial statements, required supplementary information, other combining financial statements, and schedules.
- The Statistical Section, presenting comparative financial data and other non-financial data.

This letter of transmittal is designed to complement management's discussion and analysis that immediately follows the report of the independent auditors.

PROFILE OF THE STATE OF SOUTH CAROLINA

South Carolina stretches from the Atlantic Ocean to the Blue Ridge Mountains, containing 30,111 square miles. The coastal area, which is one of the leading recreation centers on the east coast, is the anchor of the State's thriving tourism industry. Since 1970, 565,000 people have relocated to South Carolina to take advantage of its growing economy and to retire here.

As shown in the organization chart on page 13, South Carolina's government is divided into three separate branches: legislative, executive, and judicial. State government provides a full range of services to South Carolina's citizens including educational, health, social/human, transportation, public safety, regulatory, and conservation/natural resources services. In addition, the State provides grants and loans to local governments, including school districts, within its borders.

South Carolina is primarily a manufacturing state. While the textile industry is still the major industrial employer in the State, the State's economy has undergone a gradual transition to other sectors. Since 1950, the State's economic base has diversified into other sectors such as trade, health care, services, and durable goods manufacturing.

BUDGETARY AND INTERNAL CONTROLS

The Statewide Accounting and Reporting System (STARS) is the State's budgetary-basis operating accounting system. The STARS system processes cash and budgetary transactions and maintains records for all budgeted funds and some unbudgeted funds. The State's higher education institutions and most of the other enterprise entities maintain separate accrual-basis accounting systems.

The Comptroller General's Office maintains an automated annual financial reporting system as well as an automated interface between STARS and that system. The Comptroller General's Office uses these automated systems to prepare this report in accordance with generally accepted accounting principles (GAAP). State agencies that use STARS prepare year-end forms to report amounts needed to adjust their budgetary-basis balances to comply with GAAP. The Comptroller General's Office then enters the data from these forms into its GAAP financial reporting system. Additional information entered into the GAAP financial reporting system is derived from the audited financial statements of certain entities and from other supplemental data provided by those entities.

South Carolina's annual Appropriation Act includes legally adopted budgets for the Budgetary General Fund and for Total Funds. For additional information, see the notes to the required supplementary information—budgetary. The initial budget appears in the annual Appropriation Act. After the budget year begins, the State Budget and Control Board may order spending cuts if revenue collections fail to reach predicted levels.

The State's internal controls, designed by the management of the State, provide reasonable assurance that the State will achieve the following objectives:

- Reliability of financial reporting,
- Effectiveness and efficiency of operations, and
- Compliance with applicable laws and regulations.

The concept of reasonable assurance recognizes that the cost of a control should not exceed the resulting benefits.

MAJOR INITIATIVES

South Carolina legislators spent much of the 2002 session grappling with budgetary shortfalls, which seriously limited the State's ability to maintain previous levels of service. Sheltered from the full impact of the financial troubles, however, were public education and health care for the poor, the elderly and the disabled.

The General Assembly also enacted the South Carolina Homeland Security Act, a comprehensive bill that enhanced the State's ability to gather information and respond to emergencies. The State Law Enforcement Division received wiretapping authority to investigate suspected terrorist activity, and the Governor received expanded authority to declare public health emergencies.

The legislature also addressed the issue of proposed port expansion in Charleston by approving the State Ports Authority to begin environmental impact studies and other required actions preparatory to locating new terminal facilities on the west bank of the Cooper River.

ECONOMIC CONDITION AND OUTLOOK

Over the last three decades, the economy of South Carolina has grown faster than that of the rest of the country. Businesses have migrated here from all over the world to take advantage of the State's skilled labor force, competitive wages, lower-priced land, excellent port facilities, accessibility to markets, and in recent years, substantial tax incentives. Since 1970, industry has made \$83 billion of investments in plants within the State.

The 2002 *Capital Investment Report*, published by the State Department of Commerce, is a measure of announced economic activity in South Carolina during the year. According to that report, South Carolina firms realized nearly \$4.2 billion in capital investment in 2002, with nearly 21,000 new jobs created. Over the past 10 years, nearly \$50 billion has been invested in the State while more than 448,000 new jobs have been created, improving the lives and opportunities of many South Carolinians. Existing industries accounted for \$3.74 billion in capital investment and almost 16,000 new jobs in 2002, representing over 89.1% of all capital investments and 75.6% of all job creation for the year. For the ninth consecutive year, South Carolina's capital investment from internationally-based companies exceeded \$1 billion, while nearly 5,000 new jobs arose from these sources. In recent years, the State enacted economic development legislation to encourage businesses to locate in rural sections of the State by substantially increasing tax incentives for eligible companies that locate in rural areas.

The State's rural areas accounted for 8,100 new jobs created, up 25% from last year's total. This represents 38% of all job creation in South Carolina in 2002. Capital investment for rural areas was \$1.2 billion, representing 29% of all 2002 capital investment.

The State's economy has begun the 2002-2003 fiscal year with a modest slowdown in growth. Yet by comparison, employment in the State was up 310,000 in September 2002 versus its level during the recession that slowed the State's economy in 1991. The State's Board of Economic Advisors estimated that personal income growth was 3.0% to 4.0% slower than last year's rate of growth. See the management's discussion and analysis section of this report for additional information on the economic outlook for the State.

FIDUCIARY OPERATIONS

The most significant of the State's fiduciary funds are the four retirement plans administered by the South Carolina Retirement Systems. Those plans include: the South Carolina Retirement System, the Police Officers' Retirement System, the Retirement System for Members of the General Assembly, and the Retirement System for Judges and Solicitors. The State has funded all four of those plans in accordance with recommendations of the consulting actuaries, both in the current period and in past periods. The State has no net pension obligation for those plans at June 30, 2002. See Note 9, Retirement Plans, in the notes to the financial statements for more information.

CASH MANAGEMENT

The State Treasurer is responsible for managing the State's cash and investments, except for certain component units included within the reporting entity that manage and invest their own funds. State law requires full collateralization of all State Treasurer bank balances. Some component units may have collateralization policies that differ from those of the State Treasurer.

Investment income includes appreciation and depreciation in the fair value of investments. Increases in fair value during the current year, however, do not necessarily represent trends that will continue; nor is it always possible to realize such amounts, particularly in the case of temporary changes in the fair value of investments that the State plans to hold to maturity. For additional details, see Note 1f, Summary of Significant Accounting Policies, and Note 5, Deposits and Investments, in the notes to the financial statements.

RISK MANAGEMENT

The State conducts various risk control programs to help minimize losses to which it is exposed. The health insurance program conducts extensive wellness education programs that promote development and maintenance of healthful lifestyles for covered employees. The State self-funds many types of general liability and property losses rather than purchasing insurance. For additional information on the State's risk management activities, see Note 11, Insurance Activities, in the notes to the financial statements.

AUDIT

The State Auditor and KPMG LLP, an independent certified public accounting firm, jointly performed an independent audit of the State's basic financial statements for the fiscal year ended June 30, 2002. The auditors have provided an unqualified opinion, the best possible result of the audit process.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of South Carolina for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2001. To receive a Certificate of Achievement, which is valid for one year only, a government must publish an easily readable and efficiently organized CAFR. The CAFR contents must conform to rigorous program standards, including generally accepted accounting principles and applicable legal requirements. The State of South Carolina has received a Certificate of Achievement for the last fourteen consecutive years. This year, the State again plans to submit its CAFR to the GFOA's Certificate of Achievement program. We believe that South Carolina's report for the fiscal year ended June 30, 2002, continues to meet the requirements to receive the Certificate of Achievement.

ACKNOWLEDGMENTS

Production of this report would not have been possible without the support of all State agencies and component units that supplied GAAP closing data on a timely basis. We extend special appreciation to Mr. Larry Pearce, Director of Publications and Printing at the University of South Carolina, for designing the report's cover. We also are grateful to Mr. Philip G. Grose, Jr., Director of the State Budget and Control Board's Executive Institute, for writing assistance, and to Dr. William C. Gillespie, Chief Economist of the State of South Carolina, and Mr. Robert W. Martin, Economist with the Board of Economic Advisors, for providing information on the State's economy. In addition, we thank the South Carolina Department of Commerce for granting us permission to quote from its *2002 Capital Investment Report*.

Most importantly, I heartily thank Senior Assistant Comptroller General Barbara Hevener and her team of CPAs. Their professionalism and selfless devotion in preparing this complex financial document have been inspiring.

Sincerely,



Richard Eckstrom
Comptroller General